

Management

The accompanying consolidated financial statements of **MDS Inc.** have been prepared by management in accordance with generally accepted accounting principles consistently applied. The most significant of these accounting principles have been set out in note 1 to the financial statements. These statements are presented on the accrual basis of accounting. Accordingly, a precise determination of many assets and liabilities is dependent upon future events. Therefore, estimates and approximations have been made using careful judgment. Recognizing that the Company is responsible for both the integrity and objectivity of the financial statements, management is satisfied that these financial statements have been prepared within reasonable limits of materiality.

The Board of Directors has appointed an Audit Committee consisting of three outside directors. The Committee meets during the year to review with management and the auditors any significant accounting, internal control and auditing matters, and to review and finalize the annual financial statements of the Company along with the independent auditors' report prior to the submission of the financial statements to the Board of Directors for final approval.

The financial information throughout the text of this annual report is consistent with the information presented in the financial statements.

The Company's accounting procedures and related systems of internal control are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable.

External Auditors

The auditors' opinion is based upon an independent and objective examination of the Company's financial results for the year, conducted in accordance with generally accepted auditing standards. This examination encompasses an understanding and evaluation by the auditors of the Company's accounting and internal control systems as well as the obtaining of a sound understanding of the Company's business. The external auditors conduct appropriate tests of the Company's transactions and obtain sufficient audit evidence in order to provide them with reasonable assurance that the financial statements are presented fairly, in all material respects, in accordance with generally accepted accounting principles, thus enabling them to issue their report to the shareholders.

Ernst & Young LLP, Chartered Accountants, having been appointed by the shareholders to serve as the Company's external auditors, have examined the consolidated financial statements of the Company and have reported thereon in their December 18, 2002 report.

AUDITORS' REPORT

To the Shareholders of MDS Inc.

We have audited the consolidated statements of financial position of **MDS Inc.** as at October 31, 2002 and 2001 and the consolidated statements of income, retained earnings and cash flows for each of the years in the three-year period ended October 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 2002 and 2001 and the results of its operations and its cash flow for each of the years in the three-year period ended October 31, 2002 in accordance with Canadian generally accepted accounting principles.

The Company changed its methods of accounting for goodwill and other intangible assets and earnings per share in 2002, and for pension benefits in 2001, as described in note 1.

Toronto, Canada
December 18, 2002

/s/ Ernst & Young LLP
Chartered Accountants

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

As at October 31 (millions of Canadian dollars)

ASSETS

Current

| | | |
|------------------------------|--------|--------|
| Cash and cash equivalents | \$ 194 | \$ 183 |
| Accounts receivable (note 7) | 328 | 299 |
| Inventories (notes 2 & 7) | 153 | 162 |
| Income taxes recoverable | 21 | 8 |
| Prepaid expenses | 25 | 24 |
| Future tax assets (note 12) | — | 5 |

| | | |
|--|-----|-----|
| | 721 | 681 |
| Capital assets (notes 3 & 7) | 740 | 661 |
| Future tax assets (note 12) | 35 | 72 |
| Long-term investments and other (note 4) | 267 | 212 |
| Goodwill | 779 | 776 |

| | | |
|---------------------|-----------------|-----------------|
| Total assets | \$ 2,542 | \$ 2,402 |
|---------------------|-----------------|-----------------|

LIABILITIES AND SHAREHOLDERS' EQUITY

Current

| | | |
|--|-------|-------|
| Bank indebtedness (note 7) | \$ 10 | \$ 12 |
| Accounts payable and accrued liabilities | 317 | 320 |
| Deferred income | 63 | 89 |
| Income taxes payable | 17 | 22 |
| Current portion of long-term debt (note 7) | 13 | 17 |

| | | |
|--|-----|-----|
| | 420 | 460 |
| Long-term debt (note 7) | 602 | 536 |
| Deferred income and other (notes 6(b) & 8) | 59 | 81 |
| Future tax liabilities (note 12) | 51 | 21 |
| Minority interest | 56 | 61 |

| | | |
|--|-------|-------|
| | 1,188 | 1,159 |
|--|-------|-------|

(Commitments and contingencies—note 16)

Shareholders' equity

| | | |
|---|-----|-----|
| Share capital (note 9) | 805 | 789 |
| Retained earnings | 543 | 457 |
| Cumulative translation adjustment (note 18) | 6 | (3) |

| | | |
|--|-------|-------|
| | 1,354 | 1,243 |
|--|-------|-------|

| | | |
|---|-----------------|-----------------|
| Total liabilities and shareholders' equity | \$ 2,542 | \$ 2,402 |
|---|-----------------|-----------------|

Incorporated under the Canada Business Corporations Act
See accompanying notes

On behalf of the Board:

/s/ Wilfred G. Lewitt
Director

/s/ Robert W. Luba
Director

CONSOLIDATED STATEMENTS OF INCOME

| Years ended October 31 (millions of Canadian dollars) | 2002 | 2001 | 2000 |
|---|-----------------|-----------------|-----------------|
| Revenues | \$ 1,792 | \$ 1,636 | \$ 1,435 |
| Direct costs | (1,132) | (1,067) | (953) |
| Other operating costs | (369) | (342) | (265) |
| Depreciation and amortization | (87) | (78) | (59) |
| Restructuring activities, net (notes 6 & 10) | — | 2 | (14) |
| Equity earnings and investment gains | 8 | 3 | 34 |
| Operating income | 212 | 154 | 178 |
| Gain from issue of shares by a subsidiary (note 6(b)) | — | 54 | 37 |
| | 212 | 208 | 215 |
| Interest expense | (17) | (20) | (22) |
| Dividend and interest income | 6 | 12 | 11 |
| Minority interest | (5) | (2) | (9) |
| Income before income taxes | 196 | 198 | 195 |
| Income taxes (note 12)—current | (59) | (92) | (63) |
| —future | (32) | 10 | (4) |
| Income before amortization of goodwill | 105 | 116 | 128 |
| Amortization of goodwill | — | (43) | (18) |
| Net income | \$ 105 | \$ 73 | \$ 110 |
| Earnings per share (note 9(e))—basic | \$ 0.75 | \$ 0.52 | \$ 0.86 |
| —diluted | \$ 0.74 | \$ 0.51 | \$ 0.84 |

See accompanying notes

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

| Years ended October 31 (millions of Canadian dollars) | 2002 | 2001 | 2000 |
|---|---------------|---------------|---------------|
| Retained earnings, beginning of year | \$ 457 | \$ 405 | \$ 324 |
| Net income | 105 | 73 | 110 |
| Repurchase of shares and options (note 9) | (6) | (9) | (19) |
| Dividends | (13) | (12) | (10) |
| Retained earnings, end of year | \$ 543 | \$ 457 | \$ 405 |

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended October 31 (millions of Canadian dollars)

| | 2002 | 2001 | 2000 |
|--|---------------|---------------|---------------|
| Operating activities | | | |
| Net income | \$ 105 | \$ 73 | \$ 110 |
| Items not affecting current cash flow (note 14) | 169 | 79 | 59 |
| Cash flow from operations | 274 | 152 | 169 |
| Changes in non-cash working capital balances relating to operations (note 14) | (88) | (75) | (40) |
| | 186 | 77 | 129 |
| Investing activities | | | |
| Acquisitions (note 6) | (16) | (15) | (214) |
| Purchase of capital assets | (152) | (115) | (135) |
| Proceeds on divestitures | 23 | — | — |
| Purchase of long-term investments and other | (54) | (9) | (26) |
| Other | — | 14 | (10) |
| | (199) | (125) | (385) |
| Financing activities | | | |
| Long-term debt issued | 69 | 212 | 320 |
| Long-term debt repayments | (11) | (228) | (64) |
| Increase in deferred income and other | (11) | (75) | 93 |
| Payment of cash dividends | (10) | (10) | (8) |
| Issuance of shares | 5 | 5 | 206 |
| Repurchase of shares and options | (5) | (11) | (20) |
| Issuance of shares of subsidiary for cash | — | 38 | — |
| Minority interest distributions | (10) | (7) | (9) |
| Cash effects of translation of foreign subsidiaries | (1) | (3) | 1 |
| | 26 | (79) | 519 |
| Increase (decrease) in cash position during the year | 13 | (127) | 263 |
| Cash position, beginning of year | 171 | 298 | 35 |
| Cash position, end of year | \$ 184 | \$ 171 | \$ 298 |
| Cash position comprises cash and cash equivalents less bank indebtedness See accompanying notes | | | |
| Cash interest paid | \$ 19 | \$ 30 | \$ 26 |
| Cash income taxes paid | \$ 24 | \$ 62 | \$ 26 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

All tabular amounts in millions of Canadian dollars, except where noted

1. Accounting Policies

These consolidated financial statements of MDS Inc. ("MDS" or "the Company") have been prepared in accordance with Canadian generally accepted accounting principles and include the accounts of the Company, its subsidiaries and its proportionate share of the accounts of its joint ventures. All significant intercompany balances and transactions have been eliminated. The impact of material differences between Canadian and United States ("US") generally accepted accounting principles are set out in note 20.

Use of estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported values of assets and liabilities and the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from those estimates.

Significant accounting policies are as follows:

Long-term investments and other

The accounts of all subsidiary companies are consolidated from the dates of acquisition.

Investments in joint ventures are accounted for using the proportionate consolidation method. Under this method the Company's proportionate share of joint venture revenues, expenses, assets and liabilities is included in the accounts.

Investments in significantly influenced companies are accounted for by the equity method.

Other long-term investments are carried at cost. If there is an other-than-temporary decline in value, these investments are written down to the estimated net realizable value.

Inventories

Inventories are valued at the lower of cost, determined on a first-in, first-out basis, and net realizable value.

Capital assets

Capital assets are carried in the accounts at cost less accumulated depreciation and amortization. Gains and losses arising on the disposal of individual assets are recognized in income in the year of disposal.

Costs, including financing charges and certain design, construction, and installation costs, related to assets that are under construction and in the process of being readied for their intended use, are recorded as construction in progress and are not subject to depreciation.

Depreciation and amortization, which are recorded from the date on which each asset is placed in service, are provided for on a straight-line basis over the estimated useful lives of the capital assets as follows:

| | |
|------------------------|--|
| Buildings | 2.5%–4% |
| Equipment | 10%–33% |
| Computer systems | 20%–33% |
| Leaseholds | Term of the lease plus all renewal periods, to a maximum of 20 years. |
| Facility modifications | Costs of modifications to facilities owned by others to permit isotope production are deferred and amortized over the contractual production period. |

Research and development costs

The Company carries on various research and development programs, some of which are funded in part by customers and joint venture partners. Funding received is accounted for using the cost reduction approach. Net research costs are expensed as incurred. Development costs, which meet generally accepted criteria including reasonable assurance regarding future benefits, are deferred and amortized over periods ranging from three to seven years.

Goodwill

Goodwill arises on business acquisitions and comprises the excess of amounts paid over the fair value of net identifiable assets acquired.

Effective November 1, 2001, the Company adopted the requirements of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3062, "Goodwill and Other Intangible Assets." Under the new standard, goodwill and intangible assets with indefinite useful lives are no longer amortized but are subject to an impairment review at least annually. As of the adoption date, the Company completed impairment testing on the balance of goodwill and intangible assets and no impairment loss was recorded. The Company has determined that it has no intangible assets of indefinite life.

The carrying value of goodwill is assessed at least annually to determine if a permanent impairment exists. This assessment is based on the estimated fair value of the business to which the goodwill relates.

Retirement plans

MDS has adopted the new CICA recommendations with respect to accounting for pension benefits prospectively, effective November 1, 2000.

The current service cost of pensions and other post-employment benefit plans (such as medical and dental care, life insurance and compensated absences) is charged to income annually. Cost is computed on an actuarial basis using the projected benefits method and based on management's best estimates of investment yields, salary escalation and other factors. Adjustments resulting from plan amendments, experience gains and losses, or changes in assumptions are amortized over the remaining average service term of active employees.

Revenues

Revenues are recorded when goods or services are provided to customers. Certain revenues received from diagnostic laboratory testing services are subject to future adjustment on settlement and are recorded based on management's estimate of amounts that ultimately will be realized by the Company. Adjustments, if any, are recorded in the period in which negotiations are completed.

Certain contract revenues are recognized using the percentage of completion method. Losses, if any, on such contracts are provided for in full at the time they are identified. Customer advances and billings in excess of costs plus estimated profits on contracts in progress are shown as liabilities.

Stock-based compensation plan

The Company has a share-based compensation plan as described in note 9(b). No expense is recognized for this plan when stock options are granted to employees. Any consideration paid by employees for the purchase of shares on the exercise of stock options is credited to share capital. Prior to October 31, 2002, if stock options were repurchased from employees, the consideration paid, net of related tax recoveries, was charged to retained earnings. Effective October 31, 2002, the plan was changed and the Company can no longer repurchase stock options.

Income taxes

The Company follows the liability method of income tax allocation. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Investment tax credits related to the acquisition of assets are deferred and amortized to income on the same basis as the related assets while those related to current expenses are included in the determination of income.

Foreign currency translation

Foreign operations are considered self-sustaining and are translated using the current rate method. Assets and liabilities are translated using the exchange rate in effect at the year-end and revenues and expenses are translated at the average rate for the year. Exchange gains or losses on translation of the Company's net equity investment in these subsidiaries and those arising on translation of foreign currency long-term liabilities designated as hedges of these investments are recorded as a separate component of shareholders' equity. The appropriate amounts of exchange gains or losses accumulated in the separate component of shareholders' equity are reflected in income when there is a reduction in the Company's net investment in these subsidiaries resulting from a cash distribution.

Earnings per share

Effective November 1, 2001, the Company adopted CICA Handbook Section 3500, "Earnings per Share," which requires the use of the treasury stock method to calculate diluted earnings per share. The requirements of Section 3500 were adopted retroactively and diluted earnings per share figures for the prior years were restated.

Cash and cash equivalents

Cash and cash equivalents include cash on account, demand deposits, and investments with maturities of three months or less.

2. Inventories

| | 2002 | 2001 |
|----------------------------------|--------|--------|
| Raw materials | \$ 85 | \$ 70 |
| Manufacturing work in process | 23 | 22 |
| Finished goods | 37 | 47 |
| Service contract work in process | 8 | 23 |
| | \$ 153 | \$ 162 |

3. Capital Assets

| | 2002 | | 2001 | |
|--------------------------------|--------|--------------------------|--------|--------------------------|
| | Cost | Accumulated Depreciation | Cost | Accumulated Depreciation |
| Land | \$ 37 | \$ — | \$ 33 | \$ — |
| Buildings | 159 | 34 | 131 | 31 |
| Equipment | 350 | 201 | 351 | 187 |
| Computer systems | 141 | 83 | 139 | 85 |
| Leaseholds | 78 | 38 | 71 | 33 |
| Facility modifications | 40 | 23 | 43 | 29 |
| Construction in progress | 314 | — | 258 | — |
| | 1,119 | \$ 379 | 1,026 | \$ 365 |
| Less: accumulated depreciation | (379) | | (365) | |
| Net book value | \$ 740 | | \$ 661 | |

Construction in progress includes \$36 million (2001—\$29) of capitalized financing costs.

4. Long-term Investments and Other

| | 2002 | 2001 |
|--|--------|--------|
| Investments in significantly influenced companies and partnerships | \$ 42 | \$ 38 |
| Assets pledged as security on long-term debt (note 7) | 46 | 47 |
| Venture capital investments | 115 | 78 |
| Other long-term investments | 42 | 29 |
| Other intangibles | 22 | 20 |
| | 225 | 174 |
| | \$ 267 | \$ 212 |

(a) Operating income for the year includes \$8 million (2001—\$3; 2000—\$9) as the Company's share of earnings of significantly influenced companies and partnerships.

(b) Certain long-term investments are in development-stage enterprises and, as such, have not yet earned significant revenues from their intended business activities or established their commercial viability. The recovery of invested amounts and the realization of investment returns is dependent upon the successful resolution of scientific, regulatory, competitive, political and other risk factors, as well as the eventual commercial success of these enterprises. Adverse developments could result in write-downs of the carrying values of these investments.

(c) Certain of the investments in significantly influenced companies and partnerships are subject to a formal valuation by other parties. The estimated fair value of these investments, as determined by these parties, amounts to \$8 million (2001—\$20) compared with a carrying value of \$9 million (2001—\$9).

Certain of the long-term investments held by the Company are considered to be financial instruments. Among these are several investments in shares of public companies. These marketable securities had a combined market value of \$10 million (2001—\$31) and a combined carrying value of \$23 million (2001—\$24). During 2000, the Company sold some of its holdings in these securities realizing gains of \$25 million (2001—nil).

In addition to these marketable securities, the assets pledged as security on long-term debt have a fair value which approximates their carrying value. The estimated fair value of the remaining long-term investments is not readily determinable.

(d) Other intangibles includes \$14 million of unamortized deferred development costs (2001—\$18; 2000—\$20).

5. Joint Ventures

The Company conducts certain of its businesses through incorporated and unincorporated joint ventures in which it holds approximately 50% interests. Following are condensed combined balance sheets and statements of income reflecting 100% of joint venture operations in which the Company has an interest:

| | 2002 | 2001 | 2000 |
|-------------------------------------|--------|--------|--------|
| Current assets | \$ 207 | \$ 210 | \$ 215 |
| Other assets | 78 | 79 | 73 |
| | \$ 285 | \$ 289 | \$ 288 |
| Current liabilities | \$ 101 | \$ 126 | \$ 188 |
| Long-term debt | 19 | 22 | 7 |
| Equity | 165 | 141 | 93 |
| | \$ 285 | \$ 289 | \$ 288 |
| Net revenues | \$ 878 | \$ 716 | \$ 649 |
| Operating income | \$ 179 | \$ 95 | \$ 88 |
| Cash flow from operating activities | \$ 149 | \$ 70 | \$ 145 |

Cash outflow from investing activities for the joint ventures totalled \$20 million (2001—\$24; 2000—\$30) and cash inflow (outflow) from financing activities (excluding transactions with partners) totalled (\$3) million (2001—\$4; 2000—\$1).

6. Acquisitions and Divestitures

(a) Life Sciences and Health Segments

2002—During the year, the Company disposed of a part of its therapy systems business and a part of its distribution business for total proceeds of \$23 million. No gain or loss resulted from the sale of the isotope business. A loss of \$7 million was recorded on the sale of the distribution business. These businesses had annual revenues of \$14 million and \$46 million respectively.

2001—During fiscal 2001, the Company made a number of small acquisitions in the Health segment at a total cost of \$3 million. Companies acquired in fiscal 2001 had annualized revenues of \$2 million and accounted for \$1 million of revenues reported during the year.

2000—Effective April 7, 2000, the Company acquired 100% of the outstanding shares of Phoenix International Life Sciences Inc. ("Phoenix") of Montreal, Canada. Phoenix was a contract research organization with operations in Canada, the United States, and Europe. On acquisition, the Company set up a liability for integration costs of \$27 million. As at October 31, 2002, the accrual has been fully utilized.

Effective March 6, 2000, the Company acquired 100% of the outstanding shares of INH Technologies Inc., a mass spectrometry equipment and accessories company in Calgary, Canada for cash. Effective October 25, 2000, the Company acquired the remaining 50% of Protana AS ("Protana") which it did not already own. Consideration for the acquisition of Protana comprised treasury shares issued by a subsidiary of the Company. As a result, the Company's interest in this subsidiary was reduced and MDS has realized a gain from the issuance of these shares totalling \$37 million.

During 2000, the Company completed the acquisition of the shares of Scientific China, Inc. that it did not previously own. Following the acquisition, MDS fully provided for \$14 million of deferred start-up costs as restructuring activities.

Companies acquired in fiscal 2000 had annualized revenues of \$345 million and accounted for \$187 million of revenues reported in 2000.

(b) MDS Proteomics

During 2000, MDS Proteomics Inc. ("MDS Proteomics") completed an issue of 3.3 million Special Warrants, raising \$79 million in net proceeds. Each Special Warrant could be exchanged for one Common share of MDS Proteomics and was recorded as a long-term obligation in deferred income and other.

In April 2001, MDS acquired 2.9 million of the Special Warrants at a cost of \$78 million. Immediately thereafter the Special Warrants were converted to Common shares. In 2002, MDS acquired the balance of the Special Warrants for \$3 million in cash and the issuance of 334,225 Common shares.

During 2001, MDS Proteomics issued treasury shares for cash of \$38 million. As a result, the Company's interest in MDS Proteomics was reduced and MDS recorded gains from issuance of these shares totalling \$31 million. In January 2001, MDS Proteomics issued treasury shares and options in exchange for the 28% of MDS Ocata Inc. that it did not already own. As a result, MDS's interest in MDS Proteomics was reduced and MDS recorded a gain from the issuance of these shares totalling \$23 million.

During 2002, the holders of a put option relating to a previous year's acquisition caused MDS Proteomics to redeem 480,000 of its Common shares at a price of \$25 per share. MDS has recorded the payment as a purchase of an additional interest in MDS Proteomics, the majority of which has been recorded as goodwill. MDS's interest in MDS Proteomics increased to 89% because of the redemption.

The total cost of the acquisitions described in (a) and (b) above has been allocated as follows:

| | 2002 | 2001 | 2000 |
|---|-------|--------|---------|
| Working capital | \$ — | \$ (2) | \$ (77) |
| Capital assets | — | — | 95 |
| Other long-term assets | — | 1 | 42 |
| Goodwill | 14 | 49 | 481 |
| | 14 | 48 | 541 |
| Amounts previously invested | — | — | (4) |
| Long-term debt and other obligations | 10 | — | (84) |
| Minority interest | — | (33) | (3) |
| Shares issued (2002—334,225; 2000—12,500,000) | (8) | — | (236) |
| Total cash consideration | \$ 16 | \$ 15 | \$ 214 |

7. Credit Facilities

| | Maturity | 2002 | 2001 |
|-----------------------------|--------------|--------|--------|
| Long-term credit facilities | 2005 to 2015 | \$ 510 | \$ 457 |
| Other | 2003 to 2015 | 105 | 96 |
| Total long-term debt | | 615 | 553 |
| Current portion | | (13) | (17) |
| | | \$ 602 | \$ 536 |

The Company has long-term credit facilities comprising a \$150 million committed revolving five-year term loan, due June 2, 2003, a \$216 million one-year term loan due February 8, 2003 (the "Expiring Facilities") and a \$150 million 364-day extendible revolving credit with a two-year term option. Amounts borrowed under these facilities bear interest at floating rates to a maximum of prime and are unsecured and subject to certain standard covenants. Long-term credit facilities at October 31, 2002 included US\$157 million of borrowings (2001—US\$139).

Subsequent to the year-end, the Company completed a private placement of US\$311 million of Senior Unsecured Notes payable (the "Notes"). The Notes bear fixed interest at rates between 5.15% and 6.19% and have various terms between five and twelve years. Proceeds of the Notes will be used to repay and cancel the Expiring Facilities. As a result, the Expiring Facilities have been classified as long-term.

Other long-term debt includes a non-interest bearing government loan with a carrying value of \$50 million (2001—\$51) discounted at an effective interest rate of 7%. A long-term investment has been pledged as security for the repayment of this debt (note 4). The remaining debt, amounting to \$52 million (2001—\$45), bears interest at annual variable rates tied to bank prime.

Principal repayments of long-term debt, reflecting the impact of the issuance of the Notes, are required as follows:

| | |
|------------|--------|
| 2003 | \$ 13 |
| 2004 | 14 |
| 2005 | 35 |
| 2006 | 10 |
| 2007 | 22 |
| Thereafter | 521 |
| | \$ 615 |

The Company has operating lines of credit totalling \$168 million. Specific charges on accounts receivable, inventories, and capital assets have been pledged as security for certain of these lines of credit totalling \$35 million. As at October 31, 2002, the Company has borrowed \$10 million (2001—\$12) related to these credit facilities.

Under the terms of its operating and certain term credit arrangements, the Company is able to make use of bankers' acceptances to borrow at effective interest rates which are, from time to time, lower than bank prime. As bankers' acceptances or similar short-term credit vehicles represent the majority of the Company's long-term debt at October 31, 2002, the carrying value of such debt is a reasonable estimate of its fair value.

8. Deferred Income and Other

Long-term obligations include \$38 million of deferred income (2001—\$39), of which \$37 million arose as a result of the non-interest bearing debt in note 7, and is being amortized over fifteen years using the sum of the years' digits method.

9. Share Capital

(a) Summary of issued share capital

Prior to March 7, 2000, the authorized share capital consisted of an unlimited number of Class A Common shares and Class B Non-Voting shares without par value.

| (number of shares in thousands) | Class A Common | | Class B Non-Voting | | Total |
|---------------------------------|----------------|--------|--------------------|--------|--------|
| | Number | Amount | Number | Amount | Amount |
| Balance—October 31, 1999 | 12,331 | \$ 22 | 47,238 | \$ 317 | \$ 339 |
| Issued to March 6, 2000 | — | — | 54 | 2 | 2 |
| Conversions and repurchases | (2) | — | (38) | (1) | (1) |
| Balance—March 6, 2000 | 12,329 | \$ 22 | 47,254 | \$ 318 | \$ 340 |

On March 6, 2000, the shareholders of the Company approved a resolution creating a new class of Common shares for the Company. All existing Class B Non-Voting shares were converted to Common shares on a one-for-one basis. All existing Class A Common shares were converted to Common shares on the basis of 1.05 Common shares for each Class A Common share. On September 26, 2000, the Company effected a two-for-one stock split through the payment of a stock dividend. The terms of all existing share-based plans have been revised accordingly.

| (number of shares in thousands) | Common Shares | |
|---------------------------------|----------------|---------------|
| | Number | Amount |
| Balance—October 31, 2000 | 139,470 | \$ 782 |
| Issued during 2001 | 436 | 8 |
| Conversions and repurchases | (229) | (1) |
| Balance—October 31, 2001 | 139,677 | 789 |
| Issued during 2002 | 878 | 16 |
| Conversions and repurchases | (48) | — |
| Balance—October 31, 2002 | 140,507 | \$ 805 |

During the year, the Company declared and paid cash dividends of \$10 million on Common shares (2001—\$10; 2000—\$8).

During the year, the Company repurchased 48,300 Common shares (2001—228,900) for \$1 million (2001—\$4; 2000—\$6) under the terms of a Normal Course Issuer Bid. The excess over the stated capital of the acquired shares was charged to retained earnings.

(b) Stock option plan

The Company has a stock option plan (the "Plan") primarily for senior management employees. Under the terms of the Plan the Company may grant options to eligible employees and certain others to maximum amounts as set out below. The exercise price of options issued under the Plan equals the market price of the underlying shares on the date of the grant. Options vest evenly over five years and have a maximum term of ten years.

| | 2002 | | 2001 | |
|-----------------------------|---------------|----------------|---------------|----------------|
| | Number (000s) | Exercise Price | Number (000s) | Exercise Price |
| Maximum available for issue | 12,158 | | 12,315 | |
| Outstanding November 1 | 6,924 | \$ 13.87 | 6,305 | \$ 11.40 |
| Granted | 1,813 | 19.14 | 1,430 | 21.94 |
| Exercised | (157) | 3.82 | (37) | 3.59 |
| Cancelled | (858) | 11.44 | (774) | 8.89 |
| Outstanding October 31 | 7,722 | \$ 15.58 | 6,924 | \$ 13.87 |
| Options vested at year-end | 3,404 | \$ 12.07 | 3,109 | \$ 9.57 |

Options outstanding at October 31, 2002 comprise:

| Range of Exercise Prices | Weighted Average Remaining Contractual Life (Years) | Options Outstanding | | Options Exercisable | |
|--------------------------|---|---------------------|---------------------------------|---------------------|---------------------------------|
| | | Number | Weighted Average Exercise Price | Number | Weighted Average Exercise Price |
| \$ 2.97–\$ 6.35 | 3.2 | 1,508 | \$ 7.18 | 1,508 | \$ 7.18 |
| \$ 13.88–\$ 14.88 | 6.8 | 2,101 | \$ 14.13 | 968 | \$ 14.18 |
| \$ 15.45–\$ 18.98 | 8.3 | 2,473 | \$ 17.82 | 595 | \$ 15.69 |
| \$ 19.69–\$ 31.50 | 8.2 | 1,640 | \$ 21.80 | 333 | \$ 21.69 |
| | | 7,722 | \$ 15.58 | 3,404 | \$ 12.07 |

Prior to October 28, 2002, the Plan included terms which enabled option holders to request that the Company repurchase vested options. Under the terms of the Plan, approximately 654,000 options were repurchased in 2002 (2001—606,000; 2000—1,400,000) for \$8 million (2001—\$10; 2000—\$26) and cancelled. Effective October 28, 2002 the terms of the Plan were amended and option holders are no longer able to request repurchase of their vested options.

(c) Pro forma impact of stock-based compensation

Companies are required to calculate and disclose, on a pro forma basis, compensation expense related to the fair value of stock options at the grant date in the notes to the consolidated financial statements. Compensation expense for purposes of these pro forma disclosures is to be determined in accordance with a methodology prescribed in CICA Handbook Section 3870 "Stock-based compensation and other stock-based payments."

The Company has utilized the Black-Scholes option valuation model to estimate the fair value of options granted based on the following assumptions:

| | 2002 | 2001 | 2000 |
|------------------------------|-------|-------|-------|
| Risk free interest rate | 4.2% | 5.0% | 5.0% |
| Expected dividend yield | 1.0% | 1.0% | 1.0% |
| Expected volatility | 0.298 | 0.311 | 0.305 |
| Expected time until exercise | 5.25 | 5.25 | 5.25 |

The weighted average fair value of options granted is estimated at \$5.98 per Common share in 2002, \$7.39 per Common share in 2001 and \$4.85 per Common share in 2000. For purposes of these pro forma disclosures, the Company's net income and basic and diluted earnings per share would have been:

| | 2002 | 2001 | 2000 |
|--------------------------|---------|---------|---------|
| Net income | \$ 98 | \$ 65 | \$ 108 |
| Earnings per share—basic | \$ 0.70 | \$ 0.46 | \$ 0.85 |
| —diluted | \$ 0.69 | \$ 0.45 | \$ 0.83 |

For comparative purposes only, the above earnings per share amounts reflect the impact of compensation expense related to the fair value of stock options granted beginning in 2000 amortized over a five-year vesting period.

The Black-Scholes option valuation method used by the Company to determine fair values was developed for use in estimating the fair value of freely traded options that are fully transferable and have no vesting restrictions. This model requires the use of highly subjective assumptions, including future stock price volatility and expected time until exercise. Because the Company's outstanding stock options have characteristics that are significantly different from those of traded options, and because changes in any of these assumptions can materially affect the fair value estimate, in management's opinion, the existing models may not provide a reliable single measure of the fair value of its stock options.

(d) Stock Dividend and Share Purchase Plan and Employee Share Ownership Plan

Under the Company's Stock Dividend and Share Purchase Plan, shareholders may elect to receive stock dividends in lieu of cash dividends. Stock dividends are issued at not less than 95% of the five-day average market price (the "Average Market Price") of the shares traded on the Toronto Stock Exchange immediately prior to the dividend payment date. Plan participants may also make optional cash payments of up to \$3,000 semi-annually to purchase additional Common shares at the Average Market Price.

Participation in this plan for the year ended October 31, 2002 resulted in the issuance of 171,193 Common shares (2001—140,009) as stock dividends and the issuance of 14,876 Common shares (2001—20,795) for cash.

Under the terms of the Company's Employee Share Ownership Plan, eligible employees are able to purchase Common shares at 90% of the Average Market Price for the period preceding the purchase. During the year, the Company issued 168,877 Common shares (2001—179,893) under this plan for \$3 million (2001—\$3) and 740,510 are reserved for issue.

(e) Earnings per share

| (number of shares in millions) | 2002 | 2001 | 2000 |
|--|--------|-------|--------|
| Net income available to Common shareholders | \$ 105 | \$ 73 | \$ 110 |
| Weighted average number of Common shares outstanding—basic | 140 | 140 | 128 |
| Impact of stock options assumed exercised | 2 | 2 | 3 |
| Weighted average number of Common shares outstanding—diluted | 142 | 142 | 131 |

Basic earnings per share have been calculated using the weighted average number of Common shares outstanding during the period. Basic earnings per share for 2002, 2001 and 2000 were \$0.75, \$0.83 and \$1.01, respectively, and diluted earnings per share were \$0.74, \$0.81 and \$0.98 respectively.

Diluted earnings per share have been calculated, using the treasury stock method, by dividing net earnings available to Common shareholders by the sum of the weighted average number of Common shares outstanding and all additional Common shares that would have been outstanding if potentially dilutive Common shares had been issued during the year. This method computes the number of incremental shares issued by first assuming that all outstanding stock options, with an exercise price less than the Average Market Price, are exercised. Secondly, the proceeds of the options exercised are assumed to be used for the repurchase of shares using the Average Market Price of MDS Common shares for the period.

10. Restructuring Activities

During 2001, the Company exited certain lines of business and restructured certain activities in the Life Sciences segment. The Company recorded a restructuring charge to cover costs associated with these activities, all of which were subsequently incurred. In addition, as a result of the amalgamation of certain legal entities, the Company became eligible for investment tax credits related to expenditures of prior years. No restructuring activities occurred during 2002. The details of the 2001 events are as follows:

| | |
|---------------------------------|--------|
| 2001 | |
| Severance and termination | \$ (6) |
| Assets written off | (20) |
| Other | (2) |
| Investment tax credits realized | 30 |
| | 2 |
| Income taxes | (5) |
| Net income effect | \$ (3) |

11. Research, Product Development and New Business Initiatives

| | 2002 | 2001 | 2000 |
|--|-------|-------|-------|
| Gross expenditures in the year | \$ 85 | \$ 68 | \$ 56 |
| Investment tax credits | (8) | (10) | (7) |
| Recoveries from partners | (17) | (13) | (8) |
| Development costs capitalized | (7) | (4) | (13) |
| Amortization of amounts previously capitalized | 8 | 6 | 4 |
| Net expense for the year | \$ 61 | \$ 47 | \$ 32 |

12. Income Taxes

(a) Provision

The Company's effective income tax rate has the following components:

| | 2002 % | 2001 % | 2000 % |
|---|-----------|-----------|-----------|
| Combined Canadian federal and provincial tax rate | 38.4 | 42.6 | 44.0 |
| Increase (decrease) in tax rate as a result of: | | | |
| Research and development incentives | (0.8) | (2.6) | (0.6) |
| Manufacturing and processing rate | (2.0) | (2.8) | (3.2) |
| Tax rate on foreign operations | 1.6 | 4.3 | 1.0 |
| Investment dispositions and writedowns | 1.8 | 2.2 | 1.7 |
| Tax impact of minority interest and equity earnings | 0.5 | 1.1 | (0.8) |
| Federal capital taxes | 1.4 | 0.5 | 0.4 |
| Revaluation of future income tax assets | — | 4.7 | — |
| Other | 0.8 | (0.3) | (0.1) |
| | 41.7 | 49.7 | 42.4 |
| MDS Proteomics losses not recognized | 4.7 | 3.2 | — |
| Gain from issue of shares by MDS Proteomics | — | (11.5) | (8.3) |
| Effective income tax rate | 46.4 | 41.4 | 34.1 |

(b) Future tax assets and liabilities

Future tax assets and liabilities consist of the following temporary differences:

| Future tax assets | 2002 | 2001 |
|--|---------|---------|
| Tax benefits of loss carryforwards | | |
| Pre-acquisition | \$ 15 | \$ 16 |
| Post-acquisition | 48 | 55 |
| Tax basis in excess of book value | — | 7 |
| Investment tax credits | 8 | 31 |
| Provisions and reserves | 8 | 7 |
| Future tax assets before valuation allowance | 79 | 116 |
| Valuation allowance | (44) | (39) |
| Future tax assets | \$ 35 | \$ 77 |
| Future tax liabilities | | |
| Book value in excess of tax basis | \$ (57) | \$ (27) |
| Provisions and reserves | 6 | 6 |
| Future tax liabilities | (51) | (21) |
| Net future tax assets (liabilities) | \$ (17) | \$ 56 |

(c) Tax loss carryforwards

As at October 31, 2002, the Company has recorded future tax assets relating to income tax loss carryforwards of \$63 million (2001—\$71) before valuation allowances. These assets relate to \$178 million (2001—\$200) of tax loss carryforwards. Of the total losses, \$53 million (2001—\$66) expire between 2005 and 2009; \$77 million (2001—\$100) expire between 2010 and 2017; and the remaining \$48 (2001—\$34) may be carried forward indefinitely.

(d) Investment tax credits

During the year the Company recognized investment tax credits relating to research performed in Canada on its own behalf and on behalf of certain customers of \$23 million (2001—\$61). This amount was attributable to salaries and other research related expenditures incurred in the year and was recorded as a reduction of those expenses. \$13 million of the ITCs realized in 2001 related to certain capital expenditures and were recorded as a reduction in the carrying values of the related assets.

13. Retirement Plans

The Company sponsors various post-employment benefit plans including defined benefit pension plans and plans that provide extended health care coverage to employees. All defined benefit pension plans sponsored by the Company are funded plans. Other post-employment benefits are unfunded.

Net periodic benefit costs for the Company's post-employment benefit plans comprise the following components:

| | 2002 | 2001 | 2000 |
|--------------------------------------|------|------|------|
| Service cost | \$ 7 | \$ 5 | \$ 6 |
| Interest cost | 10 | 9 | 8 |
| Expected return on plan assets | (12) | (11) | (9) |
| Recognized actuarial gain | (1) | (1) | (1) |
| Amortization of net transition asset | (2) | — | — |
| Net periodic benefit cost | \$ 2 | \$ 2 | \$ 4 |

The following assumptions were used in the determination of the net periodic benefit cost:

| | 2002 | 2001 | 2000 |
|---|------|------|------|
| Return on plan assets | 7.0% | 7.0% | 7.0% |
| Real rate of return | 3.5% | 3.5% | 3.5% |
| Discount rate | 7.0% | 7.0% | 7.0% |
| Rate of compensation increase | 4.8% | 5.0% | 5.5% |
| Health care cost trend rate—first six years | 8.6% | 8.1% | 9.0% |
| —thereafter | 4.5% | 4.5% | 4.5% |

Changes in the benefit obligation for the plans were as follows:

| | 2002 | 2001 |
|---|--------|--------|
| Benefit obligations—beginning of year | \$ 139 | \$ 127 |
| Service cost—pension | 5 | 3 |
| —other benefit plans | 2 | 2 |
| Interest cost | 10 | 9 |
| Benefits paid | (2) | (2) |
| Actuarial gain | 2 | — |
| Benefit obligations—end of year | 156 | 139 |
| Non-pension benefit obligations—end of year | 14 | 12 |
| Total pension benefit obligations—end of year | \$ 170 | \$ 151 |

Changes in the assets of the plans were as follows:

| | 2002 | 2001 |
|---|--------|--------|
| Plan assets at fair value—beginning of year | \$ 162 | \$ 169 |
| Actual return on plan assets | (1) | (9) |
| Benefits paid | (2) | (2) |
| Company contributions | 2 | 2 |
| Participant contributions | 2 | 2 |
| Plan assets at fair value—end of year | \$ 163 | \$ 162 |

Amounts recognized in the Company's consolidated statements of financial position related to the pension plan consist of:

| | 2002 | 2001 |
|--|-------|--------|
| Plan assets in excess of projected obligations | \$ 7 | \$ 23 |
| Unrecognized actuarial loss (gain) | 5 | (23) |
| Unrecognized net transition asset | (2) | (3) |
| | \$ 10 | \$ (3) |

14. Cash Flow

Non-cash flow items affecting net income comprise:

| Years ended October 31 | 2002 | 2001 | 2000 |
|--|--------|-------|-------|
| Depreciation and amortization | \$ 87 | \$ 78 | \$ 59 |
| Amortization of goodwill | — | 45 | 21 |
| Deferred income | — | — | (5) |
| Minority interest | 5 | 2 | 9 |
| Future income taxes | 73 | (10) | 6 |
| Equity earnings (net of distributions) | (3) | (1) | — |
| Restructuring activities | — | 19 | 14 |
| Dilution and other losses (gains) | 7 | (54) | (45) |
| | \$ 169 | \$ 79 | \$ 59 |

Changes in non-cash working capital balances relating to operations include:

| Years ended October 31 | 2002 | 2001 | 2000 |
|--------------------------------------|---------|---------|---------|
| Accounts receivable | \$ (37) | \$ (17) | \$ (17) |
| Inventories | (4) | (24) | (11) |
| Accounts payable and deferred income | (33) | 25 | (49) |
| Income taxes | (14) | (47) | 28 |
| Other | — | (12) | 9 |
| | \$ (88) | \$ (75) | \$ (40) |

15. Segmented Information

Management has determined that the Company operates within three dominant segments—Life Sciences, Health and Proteomics. These segments are organized predominantly around customer groups identified for the businesses.

Life Sciences businesses supply products and services to manufacturers of medical products such as pharmaceuticals, medical devices and supplies. The products and services provided by Life Sciences businesses include pharmaceutical contract research services, isotopes and advanced analytical equipment.

Health businesses are focused on the provision of products and services to individuals and to institutions, which provide health care services to consumers. Health products and services include clinical laboratory testing and distribution of medical products.

Proteomics is focused on research and development in the field of proteomic-enabled drug discovery. Proteomics' products and services include capabilities in proteomics systems, technology, drug design, screening and biology.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. There are no significant inter-segment transactions.

Operating results

| | | Operating Income | | | Amortization | |
|---------------|------|------------------|--------------------------------|-----------------------------|---------------------------------------|----------|
| | | Net Revenues | (loss) before Restructuring | Restructuring Activities | Capital Assets & Other Intangibles | Goodwill |
| Life Sciences | 2002 | \$ 1,068 | \$ 205 | \$ — | \$ 52 | \$ — |
| | 2001 | 933 | 141 | 2 | 49 | 15 |
| | 2000 | 806 | 162 | (14) | 40 | 13 |
| Health | 2002 | \$ 721 | \$ 59 | \$ — | \$ 22 | \$ — |
| | 2001 | 700 | 64 | — | 19 | 10 |
| | 2000 | 627 | 42 | — | 18 | 7 |
| Proteomics | 2002 | \$ 3 | \$ (52) | \$ — | \$ 13 | \$ — |
| | 2001 | 3 | (53) | — | 10 | 20 |
| | 2000 | 2 | (12) | — | 1 | — |
| Total | 2002 | \$ 1,792 | \$ 212 | \$ — | \$ 87 | \$ — |
| | 2001 | 1,636 | 152 | 2 | 78 | 45 |
| | 2000 | 1,435 | 192 | (14) | 59 | 20 |

Financial position

| | | Total Assets | Additions | | Investment in Investees Subject to Significant Influence |
|---------------|------|--------------|-------------------|----------|---|
| | | | Capital Assets | Goodwill | |
| Life Sciences | 2002 | \$ 1,915 | \$ 130 | \$ — | \$ 33 |
| | 2001 | 1,773 | 65 | 7 | 29 |
| | 2000 | 1,831 | 203 | 470 | 28 |
| Health | 2002 | \$ 448 | \$ 19 | \$ — | \$ 9 |
| | 2001 | 431 | 21 | 4 | 9 |
| | 2000 | 402 | 25 | 12 | 9 |
| Proteomics | 2002 | \$ 179 | \$ 3 | \$ 15 | \$ — |
| | 2001 | 198 | 29 | 77 | — |
| | 2000 | 139 | 10 | 45 | — |
| Total | 2002 | \$ 2,542 | \$ 152 | \$ 15 | \$ 42 |
| | 2001 | 2,402 | 115 | 88 | 38 |
| | 2000 | 2,372 | 238 | 527 | 37 |

Revenues by customer location

| | | Canada | US | Europe | Asia | Other |
|---------------|-------------|---------------|---------------|---------------|---------------|--------------|
| Life Sciences | 2002 | \$ 91 | \$ 538 | \$ 290 | \$ 106 | \$ 43 |
| | 2001 | 64 | 492 | 257 | 88 | 32 |
| | 2000 | 67 | 409 | 227 | 69 | 34 |
| Health | 2002 | \$ 568 | \$ 153 | \$ — | \$ — | \$ — |
| | 2001 | 531 | 165 | 2 | 1 | 1 |
| | 2000 | 493 | 131 | 2 | — | 1 |
| Proteomics | 2002 | \$ — | \$ 1 | \$ 2 | \$ — | \$ — |
| | 2001 | — | 2 | 1 | — | — |
| | 2000 | — | 2 | — | — | — |
| Total | 2002 | \$ 659 | \$ 692 | \$ 292 | \$ 106 | \$ 43 |
| | 2001 | 595 | 659 | 260 | 89 | 33 |
| | 2000 | 560 | 542 | 229 | 69 | 35 |

Export sales by Canadian operations during fiscal 2002 amounted to approximately \$588 million (2001—\$506; 2000—\$456).

Capital assets and goodwill

| | | Canada | US | Europe | Asia | Goodwill |
|---------------|-------------|---------------|--------------|--------------|--------------|---------------|
| Life Sciences | 2002 | \$ 507 | \$ 37 | \$ 73 | \$ 11 | \$ 549 |
| | 2001 | 435 | 40 | 50 | 13 | 565 |
| | 2000 | 401 | 55 | 42 | 13 | 581 |
| Health | 2002 | \$ 55 | \$ 17 | \$ — | \$ — | \$ 114 |
| | 2001 | 59 | 19 | — | — | 109 |
| | 2000 | 60 | 16 | — | — | 113 |
| Proteomics | 2002 | \$ 30 | \$ — | \$ 10 | \$ — | \$ 116 |
| | 2001 | 32 | — | 13 | — | 102 |
| | 2000 | 11 | — | — | — | 51 |
| Total | 2002 | \$ 592 | \$ 54 | \$ 83 | \$ 11 | \$ 779 |
| | 2001 | 526 | 59 | 63 | 13 | 776 |
| | 2000 | 472 | 71 | 42 | 13 | 745 |

Revenues by products and services

| | | Isotopes | Analytical Equipment | Pharmaceutical Research Services | Clinical Laboratory Services | Distribution | Proteomics |
|-------|-------------|---------------|-------------------------|--|------------------------------------|---------------|-------------|
| Total | 2002 | \$ 343 | \$ 217 | \$ 508 | \$ 531 | \$ 190 | \$ 3 |
| | 2001 | 343 | 160 | 430 | 480 | 220 | 3 |
| | 2000 | 333 | 143 | 330 | 426 | 201 | 2 |

16. Commitments and Contingencies

(a) Operating expenses

As at October 31, 2002, the Company is obligated under premises and equipment leases to make minimum payments of approximately:

| | |
|------------|---------------|
| 2003 | \$ 36 |
| 2004 | 31 |
| 2005 | 26 |
| 2006 | 21 |
| 2007 | 18 |
| Thereafter | 40 |
| | \$ 172 |

Rental expense under premises and equipment leases for the year ended October 31, 2002 was \$50 million (2001—\$49; 2000—\$47).

(b) Other long-term commitments

The Company has commitments of \$63 million associated with long-term supply arrangements with Ontario Power Generation Inc. and Atomic Energy of Canada Limited ("AECL"), which provide the Company with the majority of its supply of radioisotopes. In addition, the Company has contracted with AECL for the construction of two isotope reactors and a processing facility expected to be in operation by the second half of 2003. The estimated remaining cost of construction of these facilities is \$22 million.

Other commitments and guarantees at year-end amounted to \$81 million.

Subsequent to year-end, MDS undertook to guarantee a \$20 million bank loan on behalf of an investee in exchange for warrants in the investee.

17. Financial Instruments

(a) Foreign exchange and interest rate contracts

The Company operates globally, which gives rise to a risk that its earnings and cash flows may be adversely impacted by fluctuations in foreign exchange conversion rates. From time to time the Company uses foreign exchange forward contracts to manage this foreign exchange risk. Certain Canadian operations of the Company will have net cash inflows in 2002 and subsequent years denominated in US dollars. The Company has purchased forward contracts to hedge a substantial portion of these net cash flows.

In addition, the Company utilizes forward rate agreements ("FRAs") to fix the interest rate on certain of its debt obligations and thereby reduce its exposure to fluctuations in market interest rates.

As of October 31, 2002, the Company had outstanding foreign exchange commitments to sell US\$286 million at a weighted average rate of CDN\$1.59 maturing over the next 24 months and interest rate agreements having a principal amount of US\$50 million. The counterparties for all foreign exchange forward contracts and forward rate agreements entered into by the Company are major Canadian chartered banks.

(b) Credit risk

Certain of the Company's financial assets, including cash and short-term investments, are exposed to credit risk. The Company may, from time to time, invest in debt obligations and commercial paper of governments and corporations. Such investments are limited to those issuers carrying an investment grade credit rating. In addition, the Company limits the amount which is invested in issues of any one government or corporation.

The Company is also exposed, in its normal course of business, to credit risk from its customers. A significant portion of the outstanding accounts receivable at October 31, 2002 is due from provincial health authorities. No other single party accounts for a significant balance of accounts receivable.

(c) Fair value

Short-term investments, accounts receivable, accounts payable, accrued liabilities and income taxes—These assets and liabilities have short periods to maturity and the carrying values contained in the consolidated statements of financial position approximate their estimated fair value.

Forward contracts—Forward contracts are treated as hedges for accounting purposes. As at October 31, 2002, unrecognized gains (losses) on forward contracts accounted for as hedges amounted to \$3 million (2001—(\$3)). As at October 31, 2002 unrecognized losses on interest rate agreements amounted to \$1 million (2001—\$1).

18. Cumulative Translation Adjustment

Unrealized translation adjustments arise on the translation of foreign currency denominated assets and liabilities of self-sustaining foreign operations. An unrealized foreign exchange gain of \$6 million as at October 31, 2002 (2001—loss of \$3) exists primarily due to the weakening of the Canadian dollar against the Euro and the strengthening of the Canadian dollar against the US dollar.

19. Comparative Figures

Certain figures for previous years have been reclassified to conform with the current year's financial statement presentation.

20. Reconciliation to Accounting Principles Generally Accepted in the United States

The following information is being provided to comply with certain disclosure requirements of the Securities and Exchange Commission ("SEC") of the United States.

(a) The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"), which differ in certain material respects from those applicable in the United States ("US GAAP"). The material differences, as they apply to the consolidated financial statements of the Company, are as follows:

- i) The Company designates certain foreign exchange forward contracts as a hedge of future revenue streams. Under Canadian GAAP, the resulting gains and losses on the contracts are recorded in operations when the contracts mature in future periods. US GAAP does not permit deferral of gains and losses on revenue-stream hedging unless such contracts hedge committed future sales. Unrealized gains and losses on all contracts not specifically designated as hedges of committed future sales are recorded in earnings.
- ii) Gains or losses on translation of the Company's foreign currency denominated long-term debt not accounted for as a hedge of foreign assets are deferred and amortized over the remaining term of the debt. Under US GAAP, gains or losses on translation are included in income as they arise, unless the debt was designated as a hedge of the net investment in foreign operations.
- iii) Under Canadian GAAP, costs incurred during the start-up phase of new lines of business may be capitalized if certain criteria, related primarily to recoverability, are met. The Company defers such costs of start-up activities and amortizes them over periods ranging from three to seven years.

Under Canadian GAAP, product development costs that meet certain criteria are required to be capitalized and amortized over the future periods benefited.

Under US GAAP, such costs are included in income as incurred.

iv) Under Canadian GAAP, the premium paid on stock options that are repurchased for cancellation, net of applicable taxes, is charged to retained earnings. Under US GAAP, as prescribed by APB 25, where cash payments are made in respect of options issued prior to July 1, 2000, or where options are issued having a strike price below fair market value, the premium paid or the intrinsic value is considered to be compensation expense and deducted from income.

Under Financial Accounting Standards Board FIN 44, where a company has a practice of repurchasing stock options for cancellation for cash, the stock option plan is considered to be a variable compensation plan. Increases in the intrinsic value of non-vested stock options are amortized as a deduction from income over the remaining vesting period. Increases in the intrinsic value of vested options are charged directly to income. FIN 44 applies to options issued by the Company subsequent to June 30, 2000. (During fiscal 2002, the impact of changes in the intrinsic value in such options was not material.)

v) Under US GAAP, the cost of in-process research and development acquired as a result of a business acquisition is charged to income in the current year. Under Canadian GAAP, such costs are amortized over their estimated useful lives.

vi) Dilution gains on development stage subsidiaries are not reported in income under SEC accounting requirements.

vii) Under US GAAP, certain acquisition-related restructuring costs are expensed as incurred and are not included as part of the cost of acquisitions.

viii) Under US GAAP, investments in securities that are considered to be available for sale are to be reported at fair market value. Unrealized holding gains and losses on securities considered available for sale are recorded as a component of comprehensive income until realized. A decline in the fair value of securities available for sale that is considered other than temporary in nature is to be reported as a component of net income. Under Canadian GAAP, these securities are recorded at cost less any provision for declines in value considered to be other than temporary and related gains or losses are included in income when realized.

ix) The Company has interests in certain jointly controlled entities that are required to be proportionately consolidated in the Company's Canadian GAAP financial statements. For purposes of US GAAP, these interests would be accounted for by the equity method. Net income, earnings per share and shareholders' equity under US GAAP are not impacted by the proportionate consolidation of these interests in jointly controlled entities. Summary balance sheets and income statements, along with certain cash flow information, for the Company's joint venture investees are provided in note 5.

(b) The following table presents the effects on the consolidated statements of income of the above differences:

| | 2002 | 2001 | 2000 |
|---|---------|---------|---------|
| Net income under Canadian GAAP | \$ 105 | \$ 73 | \$ 110 |
| Adjustments: | | | |
| Unrealized gains (losses) on forward foreign exchange contracts | 6 | 7 | (13) |
| Unrealized gains (losses) on foreign currency denominated debt | — | — | (5) |
| Deferred start-up and development costs | (15) | (13) | (15) |
| Pension costs | — | — | 1 |
| Stock options repurchased | (8) | (13) | (24) |
| Write-off of acquired in-process R&D | — | — | (1) |
| Gain from issue of shares by a development-stage subsidiary | — | (54) | (37) |
| Acquisition related restructuring costs | — | 1 | (5) |
| Impairment of long-term investment | — | (2) | — |
| Income taxes | 7 | 7 | 23 |
| Net income under US GAAP | \$ 95 | \$ 6 | \$ 34 |
| Earnings per share under US GAAP: | | | |
| Basic | \$ 0.68 | \$ 0.04 | \$ 0.26 |
| Diluted | \$ 0.66 | \$ 0.04 | \$ 0.26 |

Under US GAAP, the following consolidated statement of comprehensive income is required:

| | 2002 | 2001 | 2000 |
|---|-------|---------|--------|
| Net income under US GAAP | \$ 95 | \$ 6 | \$ 34 |
| Unrealized gain (loss) on share investments, net of tax | (62) | (62) | 77 |
| Foreign currency translation adjustments | — | (1) | 2 |
| Comprehensive income (loss) | \$ 33 | \$ (57) | \$ 113 |

(c) The following table indicates the significant items in the consolidated balance sheets that would have been affected had the consolidated financial statements been prepared under US GAAP. The revised amounts would have been as follows:

| | 2002 | 2001 |
|----------------------------------|--------|--------|
| Accounts receivable—trade | \$ 277 | \$ 273 |
| —other | 55 | 26 |
| Current future tax assets | 5 | 9 |
| Capital assets | 707 | 636 |
| Long-term future tax assets | 54 | 91 |
| Long-term investments | 193 | 254 |
| Goodwill | 773 | 764 |
| Accounts payable—trade | 139 | 140 |
| —other | 178 | 179 |
| Long-term future tax liabilities | 32 | 56 |
| Accumulated comprehensive income | 19 | 61 |
| Additional paid-in capital | 90 | 90 |
| Retained earnings | 379 | 304 |

(d) For purposes of US GAAP, companies are required to disclose the pro forma impact on certain financial statement balances of acquisitions made during a year. Assuming these acquisitions occurred at the beginning of each respective year it would have increased (decreased) these amounts as noted below:

| | 2002 | 2001 | 2000 |
|---------------------------|------|------|-----------|
| Revenues | \$ — | \$ 1 | \$ 159 |
| Net income | \$ — | \$ — | \$ (9) |
| Earnings (loss) per share | \$ — | \$ — | \$ (0.07) |

(e) Under accounting principles generally accepted in the United States, amortization of goodwill and restructuring provisions would be shown as part of income from operations and amortization of goodwill would not be presented on a net-of-tax basis. Earnings per share before amortization of goodwill would not be presented under accounting principles generally accepted in the United States.

ELEVEN-YEAR FINANCIAL SUMMARY

Years ended October 31 (millions of Canadian dollars, except per share data)

| | 2002 | 2001 | 2000 | 1999 |
|---|-------------|-------------|-------------|-------------|
| Operating Results | | | | |
| Revenues | \$ 1,792 | \$ 1,636 | \$ 1,435 | \$ 1,183 |
| Operating income before goodwill amortization | 212 | 154 | 178 | 154 |
| Operating income before unusual items | 212 | 154 | 178 | 154 |
| Net income before unusual items | 105 | 19 | 73 | 82 |
| Net income before goodwill amortization | 105 | 116 | 128 | 91 |
| Net income | 105 | 73 | 110 | 82 |
| Financial Position | | | | |
| Working capital | 301 | 221 | 312 | 82 |
| Capital assets | 740 | 661 | 598 | 427 |
| Other long-term assets | 1,081 | 1,060 | 996 | 444 |
| Total assets | 2,542 | 2,402 | 2,372 | 1,299 |
| Long-term debt | 615 | 553 | 551 | 213 |
| Shareholders' equity | 1,354 | 1,243 | 1,185 | 669 |
| Capital employed | 1,951 | 1,787 | 1,619 | 934 |
| Cash Flow | | | | |
| Cash from operations | 274 | 152 | 169 | 128 |
| Net share capital issued (repurchased) | — | (6) | 186 | 87 |
| Cash dividends paid | 10 | 10 | 8 | 6 |
| Capital assets purchased | 152 | 115 | 135 | 143 |
| Acquisitions (divestitures) | (7) | 15 | 214 | 53 |
| Net issue (repayment) of long-term debt | 58 | (16) | 256 | 17 |
| Per Share Data | | | | |
| Earnings per share before goodwill amortization | 0.75 | 0.83 | 1.01 | 0.78 |
| Earnings per share | 0.75 | 0.52 | 0.86 | 0.70 |
| Dividends paid | 0.0932 | 0.0863 | 0.0788 | 0.0713 |
| Book value per share | 9.63 | 8.90 | 8.50 | 5.62 |
| Price range | 25.10–18.48 | 30.00–16.66 | 31.90–13.12 | 17.43–13.76 |
| Weighted average shares outstanding (millions) | 140 | 139 | 128 | 117 |
| Statistics and Ratios | | | | |
| Current ratio | 1.71 | 1.48 | 1.67 | 1.24 |
| Long-term debt to equity | 0.45 | 0.45 | 0.46 | 0.32 |
| Return on average equity (%) | 8 | 6 | 12 | 14 |
| Pre-tax return on capital employed (%) | 11 | 9 | 14 | 16 |
| Number of Employees | 10,885 | 10,597 | 10,379 | 8,467 |

| | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 |
|--|-------------|------------|-----------|-----------|-----------|-----------|-----------|
| | \$ 1,002 | \$ 930 | \$ 819 | \$ 689 | \$ 653 | \$ 663 | \$ 459 |
| | 102 | 114 | 96 | 77 | 60 | 27 | 82 |
| | 123 | 114 | 96 | 77 | 67 | 62 | 59 |
| | 59 | 63 | 50 | 35 | 29 | 24 | 22 |
| | 52 | 68 | 54 | 38 | 37 | 4 | 37 |
| | 44 | 63 | 50 | 35 | 34 | 1 | 35 |
| | | | | | | | |
| | 79 | 43 | 91 | 61 | 106 | 121 | 125 |
| | 319 | 252 | 227 | 193 | 163 | 167 | 166 |
| | 366 | 341 | 287 | 228 | 224 | 226 | 224 |
| | 1,069 | 938 | 889 | 730 | 724 | 725 | 640 |
| | 191 | 146 | 183 | 139 | 162 | 183 | 196 |
| | 506 | 473 | 418 | 356 | 326 | 290 | 291 |
| | 874 | 759 | 590 | 512 | 470 | 455 | 449 |
| | | | | | | | |
| | 104 | 122 | 82 | 74 | 71 | 61 | 52 |
| | (12) | (8) | 38 | (1) | — | — | 1 |
| | 6 | 5 | 4 | 4 | 3 | 3 | 3 |
| | 94 | 55 | 34 | 30 | 16 | 20 | 18 |
| | 26 | 6 | 70 | 33 | 5 | 8 | 100 |
| | 39 | 38 | (32) | 40 | 35 | 16 | 18 |
| | | | | | | | |
| | 0.46 | 0.63 | 0.50 | 0.37 | 0.35 | 0.04 | 0.36 |
| | 0.51 | 0.58 | 0.47 | 0.34 | 0.32 | 0.02 | 0.34 |
| | 0.0638 | 0.0563 | 0.0500 | 0.0438 | 0.0400 | 0.0363 | 0.0363 |
| | 4.48 | 4.19 | 3.95 | 3.40 | 3.11 | 2.79 | 2.82 |
| | 17.25–12.00 | 17.38–9.35 | 9.56–5.00 | 5.00–3.31 | 3.75–3.00 | 4.19–2.65 | 5.25–3.50 |
| | 113 | 113 | 109 | 104 | 105 | 104 | 103 |
| | | | | | | | |
| | 1.36 | 1.14 | 1.32 | 1.25 | 1.50 | 1.60 | 2.00 |
| | 0.38 | 0.31 | 0.44 | 0.39 | 0.50 | 0.63 | 0.67 |
| | 9 | 14 | 13 | 10 | 11 | 1 | 13 |
| | 15 | 17 | 17 | 15 | 13 | 13 | 15 |
| | 7,065 | 6,830 | 6,670 | 6,136 | 5,863 | 5,930 | 5,223 |